STRATEGY RESEARCH PROJECT

REFORMING THE MILITARY RETIREMENT SYSTEM

BY

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USAWC CLASS OF 1999

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ABSTRACT

AUTHOR: LTC Jeffery A. Gibert

TITLE: Reforming the Military Retirement System

FORMAT: Strategy Research Project

DATE: 31 March 1999 PAGES: 41 CLASSIFICATION: Unclassified

The U.S. military plays a vital role in implementing the National Security Strategy by providing a trained, equipped, and ready force which enables national leaders to call on it as an instrument of power. As the 21st century approaches, advances in technology and other capabilities are driving a fundamental transformation of our military forces and creating a need for personnel with a variety of highly specialized skills. Compensation plays an important role in enabling the military to sustain a trained and ready force. Congress enacted The Military Retirement Reform Act of 1986 as a means to save money and induce more members to continue their service beyond 20 years, thereby giving us a more experienced and capable career force. Recently conducted surveys, however, cite great soldier dissatisfaction with today's retirement system. This study examines the current military retirement system and analyzes the feasibility of augmenting it with a savings plan similar to the 401(k) plan. This analysis of the military retirement system considers the criteria of cost, effect on retention, and ability to enhance personal financial stability.

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THE ISSUE

The goal of the 1998 National Security Strategy is:

> To ensure the protection of our nation's fundamental and enduring needs: protect the lives and safety of Americans, maintain the sovereignty of the United States with its values, institutions and territory intact, and promote the prosperity and well-being of the nation and its people.[1]

The U.S. military vitally supports this strategy by providing a trained, equipped, and ready force to meet any challenges to our nation's security. As the 21st century approaches, advances in technology and other capabilities have driven a cultural transformation of our military forces. This revolution in military affairs has yielded sophisticated weapon systems, a more inclusive military, modern information processing, along with enhanced navigation and command and control capabilities. More than ever, our military services need highly educated personnel with a variety of specialized skills.

Retention of these personnel likewise becomes important primarily because the services cannot afford to lose their valuable experience. Also, capable replacements are scarce and traditionally the closed personnel system of the military makes recruitment a tricky business. Further, recent manpower reductions have led to the loss of valuable personnel. Such losses destabilize the force, increase costs of retraining needed personnel, and detract from readiness.

The Spring 1998 Sample Survey of Military Personnel (SSMP), an Army Research Institute survey that tracks reasons why people leave the Army, cites compensation-related issues as two of the

eight primary reasons that soldiers separate from the Army.[2] The increase from 1992 to 1998 in the percent of both officers and enlisted personnel reporting the level of "retirement benefits" as a most important reason for leaving the Army has grown significantly.[3]

Dissatisfaction with retirement is not simply an Army-specific problem. A recently released survey conducted for the Air Force Chief of Staff shows that just 13 percent of first-term airmen agree with the statement "the retirement system is fair and equitable."[4] This same survey revealed that only 10 percent of second-term airmen think the retirement system is fair.

During a Congressional hearing on readiness issues held in September 1998, General Hugh Shelton, the Chairman of the Joint Chiefs of Staff, expressed his concerns about the eroding attraction of retirement pay as a career incentive. He observed that, "In 1986, Congress changed the Armed Forces retirement system to one that is increasingly perceived by our military members as simply not good enough to justify making a career of the military service."[5] During a meeting with the Army Times staff on September 21, 1998, the Army Chief of Staff, General Dennis Reimer concurred that "fixing retirement is my number one priority."[6]

Several factors have contributed to this increased focus on retirement pay. First, Congress reduced retirement benefits as military compensation came under increased scrutiny in an effort

to reduce the federal deficit in the middle 1980's. Congressional critics then believed the military retirement system was too generous. From their perspective, any plan that paid a substantial annuity, supplemented with annual cost of living allowances (COLA), to people who could retire in their late thirties and forties was too expensive. So Congress agreed that military retirement benefits should be cut to conform more to civilian standards. As a result, Congress enacted Public Law 99-348, The Military Retirement Reform Act of 1986 (known as REDUX) on 1 August 1986. This law reduced retirement benefits by eighteen to twenty-five percent for individuals joining the military after August 1, 1986.[7] These reduced benefits are now perceived by many as they approach service career decision points as not offering worthwhile inducement to make the military a career. Furthermore, the dramatic increase in civilian job opportunities created by a growing economy and low unemployment rates offers service members an attractive alternative to a military career.

This study examines the current military retirement system and evaluates the feasibility of augmenting it with a savings plan similar to the 401(k) plan. The study focuses on the active duty, non-disability military retirement system.

We will begin our analysis by first examining the historical basis for military retirement to understand its objective and main components.

HISTORY OF RETIRED PAY

Various provisions of Title 10, United States Code, address retirement authority.

> The purpose of nondisability retired and retainer pay is to establish a system and authorize payment of retired pay for service in the armed forces of the United States in order to insure that (1) the choice of career service in the armed forces is competitive with reasonably available alternatives, (2) promotion opportunities are kept open for young and able members, (3) some measure of economic security is made available to members after retirement from career military service, and (4) a pool of experienced personnel subject to recall to active duty during time of war or national emergency exists.[8]

A summary of the key legislative authorities for the retirement pay system follows:[9]

The Act of 3 August 1861 is the first authority that pertains to retirement pay. It authorized the voluntary retirement, at the discretion of the President, of Regular officers of all branches of service after 40 years of duty. Subsequently, Congress enacted numerous laws addressing retirement pay. These acts addressed retirement authority and retired pay entitlements, but offered no consistency in the method of payment or throughout the three services.

Congress introduced a form of standardization to the retirement system in 1916. The Act of 29 August 1916 established two new principles. The first principle established a retirement program integrated with an up-or-out selective promotion system that is still in existence. The second principle initiated the use of a retirement formula that was, until 1980, used to determine retired pay entitlements. That formula computed

retirement pay on 2.5 percent of monthly active duty pay for each year of service up to 30 years, or a maximum of 75 percent of such pay.

The Defense Officer Personnel Management Act (DOPMA), Public Law 96-513, dated 8 September 1980, effected the first major change in the computation of retired pay entitlements since the 1916 Act. Under DOPMA, the service member's retired pay is computed on the basis of the member's monthly base pay during the highest three years rather than the member's base pay during their last month. Since monthly base pay is computed by averaging the member's pay during their highest three years, it reduced average retired pay by six percent.[10] To keep faith with those in the service, DOPMA retirement pay computation applied only to those who became members on or after the date of the enactment of the Act.

The legislative history for enlisted personnel is much shorter than that of officers. This is due in large part to the fact that the reasons for development of the earliest forms of non-disability retirement were to provide for the involuntary retirement of aged officers. These same objectives could be met in the enlisted force by an administrative policy of nonacceptance of applications for reenlistment.

The Act of 14 February 1885 provided the first enlisted disability retirement authority. It authorized voluntary retirement, at the discretion of the Secretary concerned, of Army

and Marine Corps enlisted personnel after 30 years of service. The Act of 3 March 1899 extended the 30-year privilege to enlisted personnel in the Navy. The Act of 2 March 1907 consolidated the voluntary retirement authority for enlisted personnel of all branches of service.

The most recent major legislative change to the retirement system for both officers and enlisted was codified on 1 August 1986 in Public Law 99-348, The Military Retirement Reform Act of 1986 (REDUX). The Act made two significant changes to preceding legislation. First, it lowered the percentage multiplier used to determine the initial retirement pay from fifty percent to forty percent at 20 years. For each subsequent year of service, however, there is a 3.5 percent increase in pay rather than the increase of 2.5 percent. Both plans entitle service members after 30 years of service to 75 percent of their initial retirement pay. The second change requires the annual cost-of-living allowances to grow at one percentage point lower than the cost-of living index, with a one-time restoration of purchasing power at age 62. REDUX applies only to those individuals who joined on or after Congress enacted the law—1 August 1986.

OVERVIEW OF THE CURRENT SYSTEM

The current retirement system applies to all service members, but the actual compensation formula varies depending on the date one joined the military.[11] It is a non-contributory system that

uses years of service as the determining factor in establishing eligibility for voluntary retirement and a level of compensation.

Individuals are vested after 20 years of service and immediately receive an annuity effective upon retirement. The amount received is a percentage of their base pay at separation. Retired pay is then adjusted annually by the change in the Consumer Price Index (CPI) of the preceding year. When the retiree becomes eligible for Social Security, there is no reduction of retired pay. Generally, personnel separating with less than 20 years receive nothing. However, The National Defense Authorization Act for Fiscal Year 1993, Public Law 102-484, adopted early retirement authority for members having served between 15 and 20 years of service as a temporary measure to assist in the drawdown of military forces through 1995. This authority remains in effect until 1 October 1999.[12]

There are three distinct non-disability benefit formulas within the retirement system. While all three methods of computation guarantee monthly payments after 20 years of service and provide service members 75 percent of their final pay for 30 years of service, each subsequent method of computation reduces the amount of retirement pay a person receives. A brief description of each formula follows:

Final Basic Pay: Individuals who joined the service before 8 September 1980 receive retirement pay equal to 50 percent of their highest basic pay and full annual cost-of-living

adjustments as approved by Congress when they leave the service at 20 years. They also receive an additional 2.5 percent of final basic pay for each year after 20 years of service, up to 30 years for a total of 75 percent of basic pay. The Final Basic Pay formula applies to approximately 8.4 percent of the current active force.

High 3: For individuals who joined the service from 8 September 1980 through 31 July 1986, the method is essentially the same as the final basic pay method, except that the entitlement is based on the service member's average pay during the three years of service when he or she earned the most. For an E-7 who retires with 20 years of service and receives benefits until age 76, High 3 lowers his or her retirement pay by approximately 6 percent when compared to the Final Basic Pay formula. For example, for an E-7 at 20 years, High 3 benefits total $1,011,466 by age 76, compared to $1,076,494 for the Final Basic Pay formula. The High 3 formula applies to approximately 14.4% of the current active force.

REDUX (Military Retirement Reform Act of 1986): Individuals who joined the service after 31 July 1986 will receive 40 percent of the High 3 basic pay computation at 20 years. They also receive an additional 3.5 percent of final basic pay for each year after 20 years of service, up to 30 years. However, annual cost-of-living allowances will grow at one percentage point lower than the cost-of-living adjustment provided by the other two

plans. At age 62, the REDUX retiree "catches up" to the High 3 retiree and pay is the same for that one year. From then on COLA again lags by one percentage point. Using the same conditions described above, retirement benefits for the E-7 are lowered an additional 14 percent when comparing REDUX to High 3 and 22 percent when comparing REDUX to the Final Basic Pay formula. REDUX benefits over thirty-eight years total $840,744 compared to $1,011,466 for High 3 and $1,076,494 for the Final Basic Pay formula.[13] The REDUX formula applies to approximately 77.2 percent of the current active force.[14]

REDUX IMPLICATIONS

REDUX was enacted as a means to save money, bring military retirement more in line with civilian systems, and induce more people to continue their service beyond the 20 years. This was expected to produce a more experienced and capable career force at lower costs. Although it is impossible to determine exactly the actual effects of the 1986 Act on career decisions, studies and surveys project less than promising results. Based on a DoD econometric model for studying the effects of retirement changes on the military career force, the 1986 Act may cause more mid-term enlisted soldiers to separate from the service prior to reaching retirement eligibility.[15] A 1994 RAND Corporation study found that the 1986 Act would make career officers 10 percent less likely, in collective terms, to serve at least a 20 year career until retirement; enlisted personnel were predicted to be

20 percent less likely to serve until eligible for retirement.[16] Representative John P. Murtha (D-PA), while talking with troops in the field, noted that they said the number one reason they might not make a career in the military is that retirement isn't worth as much as it used to be.[17]

SAVINGS PLAN CONCEPT

BASIS

There has been a growing concern that the reduction in retirement benefits resulting from the REDUX method of computing retirement will result in the loss of high quality members of the armed forces. One alternative that might offset the concern and improve retention is the implementation of a payroll savings plan. Three recent independent studies conducted on the subject indicate that establishment of a payroll savings plan may positively assist the Department of Defense (DoD) with retention. Studies conducted by RAND Corporation, The Military Family Institute, and DoD will be discussed sequentially.

In March 1997, The RAND Corporation conducted a DoD Enlisted Career Intentions Survey of approximately twenty thousand randomly selected enlisted members of the Army, Air Force, Marine Corps, and the Navy.[18] The results indicated that service members regarded the opportunity to build savings was important. Only 38% of all members expressed satisfaction with their existing

opportunities to build savings.[19] Furthermore, the importance of building savings was greater with personnel on their second reenlistment than their first enlistment.

In August 1997, The Military Family Institute, a DoD sponsored research center, released the results of a study it conducted entitled "Scope and Impact of Personal Financial Management Difficulties of Service Members on the Department of the Navy."[20] Among the study's findings was a recommendation to investigate the establishment of a savings or pension plan that would be deducted from member's salaries. Establishment of such a plan would offer service members the opportunity to save for retirement while providing an additional inducement to retain their loyalty. In October 1997, the DoD Compensation Directorate performed an economic analysis of the retention effects of a thrift savings plan on retention. This analysis revealed that a thrift savings plan would positively affect retention patterns.[21]

The Department of Defense has examined several alternatives for establishing a payroll savings plan for its military members. Although positively received by many, a military payroll savings plan has not been approved for implementation, primarily due to the perceived damage it may have on the current retirement system. The evaluation that follows considers many of the features considered by DoD.

MILITARY PLAN FEATURES

The proposed military plan patterns the Thrift Savings Plan (TSP) or other plans that are available to federal employees. Contribution to the plan would be voluntary and would be made with tax-free dollars. The contributions and all earnings remain tax-free until withdrawn. Members can elect to contribute up to 5 percent of their basic pay. There will be no matching contributions by the government. Members can start or stop contributions at any time while on active duty. The fund is also portable. If separated, the member can "transfer" the fund to his or her civilian employer. The TSP offers three investment vehicles of varying risk. The "G" fund invests in short-term U.S. Treasury Securities. Its historical rate of return through 1998 has averaged 7.2 percent. The "F" fund invests in the Lehman Brothers Aggregate Bond Index. Its historical rate of return through 1998 has averaged 9 percent. The "C" fund invests in the Standard and Poors 500 Stock Index. Its historical rate of return through 1998 has averaged 19 percent.[22] Members can choose to contribute to any or all of the three funds offered by the plan.

OBJECTIVES

This plan has four objectives: (1) to serve as a tax-deferred vehicle to offset the reduced retirement benefits lost by REDUX; (2) to provide benefits that are competitive with civilian benefit packages; (3) to assure some retirement benefits for

individuals who separate from the military prior to reaching retirement eligibility; and (4) to offer a savings vehicle that is easily managed, inexpensive, and provides returns commensurate with the risk level.

Let's consider the proposed savings plan using the criteria of cost, retention effects, and ability to enhance individual financial stability.

EVALUATION CRITERIA

Evaluation criteria are consistent with the original intent of the law. They also conform to the current objective to "support and complement the manpower force requirements of the Services in order to meet national security objectives."[23] The 8th Quadrennial Review of Military Compensation (QRMC) developed a set of compensation principles designed to attract and retain quality people needed to accomplish our National Security Strategy objectives. These seven compensation principles are: effective through the spectrum of military operations, equitable, financially responsible, flexible, enhances retention, dependable, and understandable.[24] While all of the principles cited above are important, this analysis focuses on the principle of "enhances retention", since retention eventually means retirement.

ADVANTAGES AND DISADVANTAGES OF THE SAVINGS PLAN

Implementation of a 401(k) savings plan as a means to augment REDUX offers both advantages and disadvantages. In terms of cost, its effect on retention, and its ability to enhance personal financial stability, how well would a 401(k) savings plan serve the Army?

COSTS

The first advantage of this 401(k) savings proposal is that DoD would not incur any additional direct cost to implement it.[25] This is because the plan requires no matching funds provided by the government. It consists only of tax-deferred employee contributions.

The second advantage is that there are no investment management costs for DoD. All costs of managing the investment are borne by the participant, who would use the existing Federal Retirement Thrift Investment Board as administrator. This Board presently administers the TSP for over 2 million postal workers, federal civilian employees, and members of Congress and their staffs. Because of the size of the fund, the cost to administer the fund is approximately 10 percent of the industry average.[26]

The third advantage is a potential reduction in organizational costs associated with productive time lost in processing paperwork and counseling military members with financial problems. The Military Family Institute study on the

Scope and Impact of Personal Financial Management Difficulties of Service Members on the Department of the Navy found that sailors with financial difficulties significantly reduced their organization's productivity. Some experts believe the number of sailors experiencing financial difficulties totaled 15 percent, which led to a lost productivity totaling $258 million annually. Direct costs alone were conservatively estimated at $36 million, or 891 man-years alone. Table 1 summarizes the cost to the command resulting from service members' financial problems.

Consequence	Cases	Cost/ Case	Direct Cost	Years Lost
LOIs	123,000	$98.76	$12,147,480	303.68
Bad Checks	174,000	$91.88	$15,987,120	399.68
Wage Garnishment	30,000	$93.36	$2,800,000	70.00
Bankruptcy	4,300	$228,78	$983,754	24.59
NMCRS Assistance	190,000	$19.64	$3,731,030	93.28
Total			$35,649,384	891.23

Table 1 Annual Lost Productivity Costs

While a thrift savings plan would obviously not solve all of these problems, it would create improved financial responsibility and discipline on the member's behalf. This in turn would reduce current financial turbulence to some degree.

A fourth advantage is that participation in a tax-deferred savings program could more than offset the reduction in retirement compensation caused by REDUX. For example, a monthly contribution of $50 for twenty years, invested in the TSP common stock fund and left to accumulate for another 20-year period, would produce approximately $387,000 in pre-tax savings on a small investment of $12,000.[27] These earnings would supplement the retirement benefits to be received under REDUX.

While these four cost advantages to DoD are impressive, there are two cost disadvantages that should be considered in evaluating this savings plan. The first disadvantage is related to perception. Congress may view savings returns of this magnitude as an increase in benefits. This perception could then make other components of the retirement system more vulnerable to cuts.

The second disadvantage is the impact of the tax deferral aspect of the plan on overall government revenues and existing laws. While the deferral of income tax is positive for savers by lowering their taxable income, it also delays tax revenue. The Budget Enforcement Act of 1990 established caps on discretionary appropriations spending and established a "pay-as-you-go" (PAYGO) requirement for legislation affecting mandatory spending or revenue. The Office of Management and Budget (OMB) has indicated the tax-deferred nature of a TSP type of savings plan subjects it to PAYGO.[28] OMB believes the savings plan would require DoD to

provide an offset. The reduction in revenue for the entire 5-year period following the year of enactment is estimated to be approximately $77 million.[29] DoD would then have to find $77M, and the most likely source of the offset funds is the present military retirement system.[30]

EFFECTS ON RETENTION

Economic theory indicates that people make choices based upon their overall happiness or satisfaction (utility). The choice of whether to stay in the military or seek employment in the civilian sector is therefore a balancing act between the relative compensation levels and a person's overall utility.

As previously mentioned, the results of the Spring 1998 Sample Survey of Military Personnel (SSMP) revealed a significant increase from 1992 to 1998 in the percent of both officers and enlisted personnel reporting the level of "retirement benefits" as a most important reason for leaving the Army.[31] The percentage of Officers reported leaving the Army because of retirement benefits increased from 4 percent to 9 percent, while the percentage of enlisted reported leaving for the same reason increased from 4 percent to 11 percent. These increases were greatest among all other categories, which clearly shows that growing dissatisfaction with retirement is an increasingly troublesome matter. Table Two summarizes the reasons officers leave the Army. Table Three provides the same analysis for enlisted Army personnel.

The preliminary results of the 1997 Enlisted Career Intentions Survey (ECI study) conducted by the RAND Corporation indicate there is a relationship between savings and retention. Approximately 70 percent of the members who completed the survey responded that "opportunities to build up my savings" would influence their decision to reenlist or separate from service.

Reason	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
-Amount of time separated from family	10.3%	10.7%	9.1%	9.8%	11.0%	11.1%	12.9%
-Amount of pay (basic)	5.7%	5.3%	6.4%	8.9%	7.9%	8.7%	10.7%
-Amount of enjoyment from my job	8.7%	7.6%	12.6%	9.5%	10.3%	9.2%	10.5%
-Overall quality of Army life	9.9%	8.5%	6.6%	6.7%	6.9%	8.5%	10.2%
-Retirement benefits	**2.0%**	**2.3%**	**3.3%**	**3.7%**	**4.5%**	**7.5%**	**9.3%**
-Job security	11.6%	10.6%	11.5%	10.1%	6.4%	7.1%	4.3%
-Promotion/ advancement opportunities	9.8%	9.9%	8.4%	9.9%	8.4%	6.3%	4.3%
-Level of job fulfillment/ challenge	8.1%	6.3%	5.2%	4.7%	5.1%	6.5%	3.8%

Table 2 Reasons for Leaving the Army—Spring 1998: Officers

Those members who were in their second enlistment were most likely to indicate that lack of opportunities to build savings

was leading them to separate from service.[32] People in their second enlistment are those the services need to retain because their skills and experience are vitally needed in our high-tech military.

Reason	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
-Amount of time separated from family	15.4%	11.9%	8.5%	8.4%	11.2%	10.4%	10.2%
-Amount of pay (basic)	11.4%	9.7%	13.9%	16.6%	14.3%	16.7%	16.6%
-Amount of enjoyment from my job	5.8%	5.3%	5.3%	5.5%	4.9%	5.5%	5.8%
-Overall quality of Army life	17.2%	16.5%	12.3%	12.1%	11.6%	12.9%	12.0%
Retirement benefits	**1.3%**	**1.7%**	**2.2%**	**3.7%**	**7.1%**	**9.7%**	**10.6%**
-Job security	5.1%	3.5%	4.0%	2.8%	3.0%	2.5%	1.9%
-Promotion/ advancement opportunities	9.8%	7.4%	9.5%	10.4%	9.1%	6.3%	5.7%
-Quality of leadership at your place of duty	3.3%	5.0%	4.2%	4.5%	4.8%	2.6%	5.3%

Table 3 Reasons for Leaving the Army—Spring 1998: Enlisted

One of the criticisms of the current retirement system is its inability to provide benefits to individuals that separate prior to attaining 20 years of service. The fact that only 30-40

percent of officer entrants and 10 to 15 percent of enlisted entrants will stay for a full 20-year career and receive benefits is seen as unfair to those who receive no benefits for less time served.[33] A clear advantage of a savings plan is that it helps alleviate this perception.

Another advantage of implementing a savings plan is the positive effect it produces on retention by providing the service member an alternative comparable to that of a civilian 401(k) plan. Fifty-nine percent of the uniformed service members are under age thirty, and ninety-one percent are under age forty.[34] As the value of these members' savings accounts begins to grow, they may have a greater incentive to remain on active duty with the goal of maximizing their savings before retirement.

The major disadvantage this savings plan has on retention is its portability. The current military retirement system, which requires 20 years service for vesting, was designed to create a significant compensation incentive to retain highly trained and capable people who would endure extraordinary demands and sacrifices for two decades or more. Portability could induce members to leave the service early, thereby causing a readiness issue in addition to increasing retraining costs. There is no valid way to measure this risk, but it is one that must be carefully considered.

ABILITY TO ENHANCE PERSONAL FINANCIAL STABILITY

Payroll savings are part of the compensation and benefit packages of many civilian employers. Approximately 83 percent of service members separate from the service with no retirement benefits.[35] Access to a savings plan would lessen the financial hardship they are subject to both during and after leaving the service.

The military is one of the few organizations exempt from the Employee Retirement Income Security Act (ERISA), the federal law that requires private sector employers to vest employees in their retirement systems after (usually) five years of service.[36] A savings plan provides service members with the same financial advantages that the public sector enjoys. This is simply a fairness issue.

Another advantage is that a savings plan supports the President's goal of increasing savings for the nation. The issue of long-term personal savings has become a matter of national concern. On 20 November 1997, the President signed Public Law 105-92, the "Savings are Vital to Everyone Act of 1997." One main feature of the law is to advance the public's knowledge and understanding of retirement savings and the critical importance of saving to the future well-being of American workers and their families.[37] The military needs to be part of this program and needs a vehicle to encourage savings as young people enter the services.

The United States ranks 27th of 29 leading industrialized countries in its national savings rate.[38] This trend is not improving as evidenced by a recent report indicating a decline in the savings rate for the Nation.[39] Individual savings rates of members of the armed forces are low, even when compared to the low savings rates of the civilian sector.[40] This low savings rate and the lack of a formal savings plan contribute to the financial insecurity of many military families. A savings plan would reverse this adverse trend.

The main disadvantage in implementing the savings plan is that low projected participation rates may diminish its effect. Critics feel a savings program is a great concept, but projected participation rates for the people who can most benefit from it—the junior enlisted—are dismal. The reason is that they have barely enough money to meet their daily financial requirements, let alone to be able to contribute to a savings plan. Their participation rate is estimated at approximately 10-20 percent.[41] Critics also feel that it is not worth jeopardizing current retirement entitlements if there will be such a low participation rate.[42] As an alternative, they believe that the Roth IRA provides the vast majority of active duty personnel with equivalent or greater after-tax benefits than a TSP based savings plan—without incurring the long-term risk to the military retirement system.

In summary, the assessment of cost, effects on retention, and the ability to provide financial stability suggest the advantages of a military savings plan outweigh the disadvantages. Conversely, the most significant disadvantage, portability, could negatively affect force structure and readiness. This risk must not be taken lightly. However, this risk is worth taking, given the potential long-term gains that can be obtained for both DoD and service members.

CONCLUSION

As we prepare for the challenges of the 21st century, people will continue to remain the linchpin to successfully exploiting our military capabilities across the spectrum of conflict.[43] Accordingly, the military's success finally hinges on its ability to recruit and maintain a quality force. Economic theory indicates that people make choices based upon their overall happiness or satisfaction. The choice of whether to stay in the military or seek employment in the civilian sector is therefore a balancing act between the relative compensation levels and a person's overall utility. Balancing a lifestyle of increased deployments, reduced benefits, and constantly eroding benefits against a booming economy and low unemployment requires that the military retirement system be reformed if it is to remain an effective career incentive.

REDUX was enacted in 1986 to reduce military retirement costs and bring military retirement closer to civilian systems. It also sought to encourage service beyond 20 years, thereby producing a more experienced and capable career force at lower cost. However, recent surveys and feedback to senior leaders indicate more dissatisfaction with the system than support. It is simply not working. Initiatives to repeal REDUX may result in short-term victories, but long-term defeat is on the horizon as costs escalate and the pendulum of budget cuts again swings in the opposite direction.

Implementation of a savings plan as described in this study offers both a viable short- and long-term solution. Research cited indicates there is a positive relationship between savings and retention. Furthermore, such a plan supports the nation's savings goals and provides for a more secure retirement while allowing military members savings opportunities comparable to those of civilians. It also meets the legislative intent of providing some measure of economic security to members after retirement and of making the choice of career service in the armed forces competitive with reasonable available alternatives. Lastly, DoD would not incur additional costs to administer the program.

The two major reservations about implementing this savings plan center on its effect on tax revenues and the potential impact it can cause to the current retirement system. The

estimated loss of $77 million in tax revenues over the first five years appears miniscule when viewed as a percentage of the total federal budget and when compared to the potential returns garnered by maintaining experienced service members. As for its threat to the current system, with or without a savings plan, the likelihood of cuts remain. Within DoD alone, competing demands for resources persist as we continually strive to sustain current operations, conduct contingency operations, and modernize the force. Absent any top line budget increases, one of the first categories considered for budget cuts is the retirement account, as evidenced by REDUX in 1986.

Implementation of a savings plan represents a win-win situation for both DoD and the service member. A savings plan would enable DoD to maintain a highly trained force that possesses the variety of highly specialized skills needed for the 21st Century. Additionally, the savings plan assists the service member in developing the important habit of saving for the future while remaining committed and loyal to the profession of arms. Implementation of a savings plan is a risk worth taking. We should remember that Congress never changed retirements of those already vested in a system.

The Army Chief of Staff, General Reimer, asserts that soldiers are our credentials.[44] It only requires a short leap to adapt this Army value to all of the nation's armed forces. A trained and ready, high quality force is the key to our ability

to successfully implement the National Security Strategy. Our challenge is to find a credible way to take care of our most valuable resource—our military personnel. This proposal for augmenting the military retirement system with a savings plan offers a viable solution to stem mass exodus and destabilizing attrition. However we choose to describe the numbers of service members choosing careers in other than national defense, we acknowledge that they are voting in record numbers with their feet—to the rear. It's time to get them marching forward to a decent retirement, following a vital career of service.

POSTSCRIPT

On 24 February 1999, the Soldiers', Sailors', Airmen's, and Marines' Bill of Rights passed by the Senate proposed two changes to the current retirement system. Their first proposal recommended either repealing REDUX or augmenting the current plan with a $30,000 bonus. Their second proposal recommended the establishment of a tax-deferred savings plan.[45] Although this study was initiated prior to the one conducted by Congress, both analyses have identified the establishment of a savings plan as a feasible solution to improving the current retirement system.

WORD COUNT - 5604.

ENDNOTES

[1] The White House, A National Security Strategy for a New Century (Washington, D.C.: U.S. Government Printing Office, October 1998), 5.

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[4] Jack Weible, "No Thanks! The 40 percent retirement plan has troops reconsidering military careers," Air Force Times, 27 April 1998, p. 11.

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[10] The six percent is for an E-7 with 20 years. The reduction for an 04 with 20 years is eight percent.

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[25] General Accounting Office, Military Retirement: Possible Changes Merit Further Evaluation (Washington, D.C.: U.S. Government Printing Office, November 1996), 31.

[26] Saul, 1.

[27] Based on an average annual rate of return of 11 percent.

[28] Carl Witschonke, "Assessment of the Cost and Benefits of a Uniform Services Payroll Savings Plan (UPSP)," Draft memorandum for Executive Secretary, Assistant Secretary of Defense, Washington, D.C., undated-document never formally submitted.

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[30] Paul B. Anderson, "H.R. 3933, 105th Congress, 'To amend titles 5 & 37 of the U.S. Code to allow members of the armed forces to participate in the Thrift Savings Plan'," Memorandum for General Counsel, Department of Defense, Washington, D.C., 22 September 1998.

[31] Peterson, 1.

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[38] Witschonke, 3.

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[42] Arcari, Paul W., "The Retired Officers Association's (TROA) position on the military Thrift Savings Plan (TSP) proposal," Memorandum for Chief, Resources Division, DCS/Personnel, HQ US Army, Washington, D.C., 14 January 1997.

[43] The White House, 24.

[44] This is a phrase commonly stated by General Reimer, usually at the conclusion of a speech.

[45] Rick Maze, "Pay Plan (Explained)," Army Times, 22 March 1999, p. 18.

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